

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA,

Petitioner,

No. C 05-3792 PJH

v.

**ORDER REOPENING CASE AND
ENFORCING IRS SUMMONSES;
REQUIRING STATUS STATEMENT
IN RELATED CASE**

JOHN C. COHAN, aka Christopher Cohan,

Respondent.

UNITED STATES OF AMERICA,

Petitioner,

No. C 05-3791 PJH

v.

MAX D. GRAY,

Respondent.

The United States' Motion to Reopen the Case and Enforce IRS Summonses came on for hearing before this court on May 16, 2007. Respondent John C. Cohan ("Cohan") appeared through his counsel, Edward M. Robbins. The United States appeared through its counsel, W. Carl Hankla. Having read all the papers submitted and carefully considered the relevant legal authority, the court hereby GRANTS the government's motion for the following reasons and for the reasons stated at the hearing.

BACKGROUND

The IRS is conducting an investigation into Cohan's income tax liability for tax year 1998. The focus of the investigation is on a package of three interrelated tax shelters

1 Cohan purchased for approximately \$14 million in an attempt to avoid income tax and
 2 transferee liability on the 1998 sale of his wholly owned cable TV corporation Sonic
 3 Enterprises, Inc.'s ("Sonic") assets. The government describes these three transactions
 4 as:

- 5 (1) a Notice 2000-44 Son of Boss transaction to generate an
 6 artificially high basis for Cohan's stock in Sonic, which owned
 7 the cable TV assets ("Foghorn Transaction");
- 8 (2) a Notice 2001-45 basis-shifting transaction to further inflate
 9 Cohan's basis in Sonic ("Stockton Street Transaction");
- 10 (3) a Notice 2001-16 intermediary transaction to transfer Sonic
 11 stock to a straw person to evade corporate-level tax upon the
 12 sale of Sonic's cable TV assets, increasing Cohan's profits in
 13 the sale of his cable TV business ("Midco Transaction").

14 The government brought related proceedings in this court pursuant to 28 U.S.C. §§
 15 7402(b) and 7604(a) of the Internal Revenue Code for judicial enforcement of IRS
 16 summonses served on Cohan, and IRS summonses served on Cohan's then-attorney, Max
 17 D. Gray¹ ("Gray"). The government filed petitions on September 20, 2005, seeking the
 18 documents Cohan refused to produce in response to those summonses. Specifically, the
 19 government sought 93 documents which, although responsive to the summonses, were
 20 withheld by Cohan as subject to attorney-client privilege. The government contended that
 21 Cohan waived the privilege by asserting an advice-of-counsel defense.

22 At the December 7, 2005 hearing on the government's petitions, the court ordered
 23 that "upon the assertion of the . . . reliance on advice-of-counsel defense, that Mr. Cohan
 24 simultaneously disclose to the United States the documents that have been withheld on the
 25 privilege log." At that hearing, Mr. Cohan's counsel stated that "if Mr. Cohan raises [advice-
 26 of-counsel defense]," the government would be entitled to the information and would "get
 27 the documents."

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¹ The Gray case was stayed pending Cohan's decision regarding whether to waive attorney-client privilege.

1 On December 8, 2005, the court issued a written order finding that Cohan
2 established a prima facie case of attorney-client privilege and denying the government's
3 request for an *in camera* review of the withheld documents. The court further found that
4 Cohan had not yet waived the attorney-client privilege by asserting the advice-of-counsel
5 defense, noting:

6 Neither party disputes that once the defense is asserted as a basis
7 for relief from penalties, the privilege is waived. Accordingly, once the
8 IRS has issued the expected notice of deficiency and Cohan files a
9 petition with the Tax Court, Cohan shall immediately advise the
government whether he will assert such defense, and if so, shall
simultaneously produce to the government the 93 withheld documents.

10 The court also noted that the government could seek to have the case reopened
11 should Cohan fail to comply with the order.

12 On December 30, 2005, the IRS issued a statutory notice of deficiency to Cohan,
13 which included penalties. He and his wife then filed a petition and an amended Tax Court
14 petition (on May 1, 2006) to contest the tax deficiency and penalties. Cohan conceded that
15 two transactions – the “Foghorn Transaction” and the “Stockton Street Transaction” were
16 invalid for tax purposes, and he asserted an advice-of-counsel defense with regards to
17 those transactions. In his amended petition, Cohan does not mention the Midco
18 Transaction. Cohan claims that the 93 privileged documents relate to the “asset sale” of
19 the actual cable TV business deal rather than the Stockton Street and Foghorn
20 Transactions. Because he is only asserting the advice-of-counsel defense with regards to
21 the latter transactions, he claims he should not have to produce the documents.

22 The government claims that all of these transactions were designed to avoid tax at
23 the corporate level on capital gain from the asset sale, to avoid ordinary income and/or
24 capital gains at the individual level triggered by distribution of sale proceeds to Cohan, and
25 to avoid transferee liability at the individual level. The government contends that the 93
26 documents on the privilege log are related to the tax shelter transactions, including the
27 Midco Transaction. The government requests these documents, as well as additional
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1 "Binder 116" documents, identified by the IRS after the court entered its last order, and now
2 seeks to reopen the case and obtain an order enforcing the IRS summonses at issue.

3 DISCUSSION

4 A. Legal Standard

5 The IRS may issue a summons only for the purposes set out in 26 U.S.C. § 7602(a).
6 *Crystal v. United States*, 172 F.3d 1141, 1143 (9th Cir. 1999). Those purposes include
7 "ascertaining the correctness of any return, making a return where none has been made,
8 determining the liability of any person for any internal revenue tax . . . or collecting any such
9 liability." 26 U.S.C. §7602(a). To enforce an IRS summons, the government must
10 establish that: (1) the investigation will be conducted for a legitimate purpose; (2) the
11 material being sought is relevant to that purpose; (3) the information sought is not already
12 in the IRS's possession; and (4) the IRS complied with all the administrative steps required
13 by the Internal Revenue Code. *Crystal*, 172 F.3d at 1143-44 (citing *United States v.*
14 *Powell*, 379 U.S. 48, 57-58 (1964)). "The government's burden is a slight one, and may be
15 satisfied by a declaration from the investigating agent that the *Powell* requirements have
16 been met." *Id.*

17 Because the court has already found this burden has been met, the burden then
18 shifts to Cohan to show why the summonses should not be enforced. *See Liberty Fin.*, 778
19 F.2d at 1392. The party asserting the attorney-client privilege has the burden of proving
20 that the privilege applies to a given set of documents or communications. *See In re Grand*
21 *Jury Investigation*, 974 F.2d 1068, 1070-71 (9th Cir. 1992). To meet this burden, a party
22 asserting the privilege must make a *prima facie* showing that the privilege protects the
23 information the party intends to withhold. *Id.* On December 8, 2005, this court found that
24 Cohan's privilege log, "which shall be supplemented within one week by a declaration to be
25 prepared by Cohan's counsel in accordance with the court's instructions at the hearing," is
26 sufficient to establish a *prima facie* case of attorney-client privilege. However, the court
27 found that privilege would be waived if Cohan asserted a reliance on advice-of-counsel
28 defense.

1 B. The Government's Motion

2 1. The Motion is Timely

3 Cohan first argues that the government waited too long to seek to reopen the case.
4 The government's motion is timely. The government moves to reopen the case pursuant to
5 the court's December 8, 2005 Order, which stated that the government could seek to
6 reopen the case should Cohan fail to produce the 93 withheld documents when he
7 asserted the advice-of-counsel defense in Tax Court. On May 1, 2006, Cohan asserted
8 that defense. The government filed the instant motion on February 20, 2007. No deadline
9 was set for filing the motion in the court's order, and the government has not waived any of
10 its arguments. This is especially true here, where Cohan's refusal to produce the privileged
11 documents was in violation of the plain language of the court's December 8, 2005 Order.
12 Cohan's attorney represented to the court that he would "cough those [93 privileged]
13 documents right up" should Cohan rely on the advice-of-counsel defense. Cohan never
14 indicated that he would produce a narrower subset of documents if he relied on that
15 defense for certain limited transactions. Yet, despite the fact the court ordered him to
16 produce all 93 documents when he asserted the advice-of-counsel defense, Cohan never
17 sought modification of the court's order when he decided not to comply with it.

18 2. Admissibility of McKenna Declaration

19 The government submits two declarations from IRS Agent Bernard McKenna
20 ("McKenna") in support of its motion.

21 Cohan argues that McKenna's declaration is not proper expert testimony, noting that
22 the government has not attempted to qualify McKenna as an expert.² IRS agents,
23 however, may give expert opinions. *See United States v. Tarwater*, 308 F.3d 494, 513 (6th
24 Cir. 2002); *see also United States v. Wade*, 203 Fed. Appx. 920, 930 (10th Cir. 2006)
25 ("properly qualified IRS agent may analyze a transaction and give expert testimony about
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27 ² Cohan also argues that the government has not followed disclosure
28 requirements of Federal Rule of Civil Procedure 26 pertaining to experts. Rule
 26(a)(1)(E)(v), however, exempts actions to enforce administrative summonses
 from the initial disclosure requirements.

1 its tax consequences"). McKenna has a B.S. degree in accounting, a M.S. degree in
2 taxation, and experience as a Revenue Agent for over 26 years, including experience in a
3 tax-shelter examination group and experience as an instructor. He has spent over 1000
4 hours investigating the Cohan case and looking at the various documents. Cohan has not
5 made any specific objections to McKenna's qualifications. The court finds that McKenna is
6 qualified to give expert opinion.

7 At the hearing, Cohan requested the opportunity to hire an additional expert to rebut
8 McKenna's opinions. The court allowed Cohan to submit an expert declaration, and he did
9 so on June 5, 2007. The court has considered that declaration, as well as McKenna's
10 declaration, in analyzing whether Cohan has waived the attorney-client privilege, as
11 discussed below.

12 3. Waiver of Privilege

13 The Ninth Circuit employs a three-pronged test in determining whether the attorney-
14 client privilege has been waived. See *United States v. Amlani*, 169 F.3d 1189, 1995 (9th
15 Cir. 1995). A waiver is effected where (1) a party raises an affirmative defense, (2) that
16 puts in issue communications otherwise privileged, and (3) upholding the privilege would
17 deny the opposing party access to vital facts. *Id.* (upholding finding that appellant waived
18 his attorney-client privilege by asserting a counsel disparagement claim).

19 Here, as Cohan has conceded, he raised the advice-of-counsel defense and waived
20 attorney-client privilege with respect to the Stockton Street and Foghorn transactions. By
21 including all of the 93 withheld documents on his privilege log, Cohan has already
22 conceded that all of these documents are relevant to the IRS's investigation. Clearly, the
23 two transactions for which Cohan asserted his advice-of-counsel defense are part of the
24 IRS's investigation. Neither Cohan nor his expert refute this assertion by Agent McKenna.
25 While Cohan asks this court to determine the merits of how exactly the tax shelters being
26 investigated are related to one another, the issue is whether Cohan's waiver of privilege is
27 broad enough to encompass all aspects of this particular IRS investigation. Moreover,
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1 Cohan's decision-making process regarding which tax-shelters to choose and how to
2 structure the various transactions is relevant to his advice-of-counsel defense.

3 Furthermore, apart from the fact that all of the transactions at issue are part of the
4 IRS investigation involved here, the facts indicate that the transactions although separate,
5 have some relationship to one another. McKenna opines that Cohan bought a package of
6 three interrelated tax shelters. All three tax shelters (Midco, Stockton Street, and Foghorn)
7 were promoted, funded, and closed as a package deal to provide Cohan shelter at both the
8 corporate and individual level. This package was referred to by his attorney as a "turn-key
9 deal." The Stockton Street and Foghorn transactions served to avoid recognition of
10 deferred intercompany gain and asset sale capital gains on the corporate returns and
11 inflate Cohan's stock basis, avoiding recognition of gains resulting from the reported Midco
12 transaction on his individual return. McKenna Decl. ¶ 10.³ Avram Salkin's declaration,
13 submitted by Cohan, does not refute the fact that the transactions were related in some
14 way. He merely concludes that the transactions are differentiated from one another, but he
15 acknowledges they all concern the sale of Sonic. Salkin Decl. ¶¶ 3-5.

16 Upholding the privilege here would deny the government access to vital facts. As
17 the *Amlani* court noted, "where a party raises a claim which in fairness requires disclosure
18 of the protected communication, the [attorney-client] privilege may be implicitly waived." *Id.*
19 (citing *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992)). To refute
20 Cohan's contention that he relied on his counsel's advice with regards to transactions
21 designed to avoid recognition of gains from the sale of Sonic, the government must have
22 access to communications that describe counsel's advice with regards to all of the
23 underlying transactions the IRS is examining in this particular investigation. *See id.*
24 ("Amlani cannot assert that certain factors caused him to discharge his attorney and then
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26 ³ Gray's IRS interview transcript also provides support for a conclusion that the
27 transactions are related. Gray refers to all of the various transactions in the 1997-1998 time
28 period as "the transaction". See Gray Tr. at 8-9. He notes that various companies developed
parallel proposals for the transactions in 1997, noting that one such proposal was "all inclusive"
and for "the whole transaction, from beginning to end." *Id.* at 28, 85, 87-88, 150. He also
notes that the different transactions were difficult to distinguish. *Id.* at 133:17-20.

1 invoke the attorney-client privilege to prevent the government from examining the situation
2 further. We have made it clear that ‘the privilege which protects attorney-client
3 communications may not be used both as a sword and a shield.’”) (citations omitted). In
4 addition, there are really no alternative sources of evidence to evaluate Cohan’s advice-of-
5 counsel defense. *See id.*

6 Cohan relies on *Bittaker v. Woodford*, 331 F.3d 715 (9th Cir. 2003) to argue that
7 even if the three transactions are interrelated, waiver of the privilege on two of the
8 transactions does not amount to a waiver of the privilege on the remaining transaction,
9 because such waiver is to be narrowly construed. In *Bittaker*, an inmate was convicted of
10 multiple murders and was sentenced to death. He filed a federal habeas petition raising a
11 variety of ineffective assistance of counsel claims. The district court entered a protective
12 order precluding the use of attorney-client privileged materials for any other purpose than
13 litigating the habeas corpus petition. The Ninth Circuit affirmed, adopting a narrow waiver
14 rule, holding that the scope of the inmate’s waiver extended only to the federal habeas
15 petition, and that the privilege was not waived for all time and all purposes. *Id.* at 722. This
16 case does not support Cohan: the issue in *Bittaker* was whether waiver was effective
17 beyond the instant proceeding. In accordance with *Bittaker*, Cohan’s privilege is not
18 waived for subsequent or different IRS investigations or prosecutions. It is, however,
19 waived for the IRS proceeding in which he has asserted the advice-of-counsel defense.

20 4. Binder 116 Documents

21 The government also requests documents from Binder 116, which came into
22 Cohan’s possession after the original summonses were served. To the extent that Cohan
23 withholds these documents on the basis of privilege, these documents must be produced
24 for the reasons described above. Cohan also claims that certain documents in the binder
25 relate to Fortrend International (“Fortrend”) and are not responsive to the government’s
26 subpoenas.

27 The subpoenas, however, expressly request documents from Gray’s files. The
28 documents are bates-stamped “MG”, indicating that they were in Gray’s files, and are

1 therefore responsive to the subpoena. The subpoenas also request documents showing
2 communications exchanged after January 1, 1997 between certain persons (including Gray
3 and Cohan) concerning the sale of Sonic stock, engagement of Presidio Advisory LLC, etc.
4 See *id.* at 3. It also requested documents concerning Cohan's tax strategy. Fortrend and
5 Presidio submitted competing proposals to Cohan regarding the Midco transaction being
6 investigated by the IRS. See Gray Tr. at 10, 28. These documents, therefore, are
7 responsive to the government's subpoena, and Cohan shall produce them.

8 CONCLUSION

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10 In accordance with the foregoing, the government's motion is GRANTED. Cohan
11 shall produce the 93 documents identified in the privilege log, as well as the documents in
12 Binder 116 within 10 days of this order. The court file shall be closed.

13 Case No. 05-3791

14 It is further ordered that the parties in related case number 05-3791 PJH shall
15 submit a further joint status statement within 10 days of this order.

16 IT IS SO ORDERED.

17 Dated: June 26, 2007



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19 PHYLLIS J. HAMILTON
United States District Judge